



Legislative Research Council

RETIREMENT LAWS COMMITTEE MINUTES

First Meeting
2004 Interim
June 10, 2004

Ramkota Inn
Pierre, South Dakota

The first meeting of the 2004 interim of the Legislature's Retirement Laws Committee was called to order by Senator William Earley at 9:05 a.m., June 10, 2004, in the Lake Francis Case Room of the Ramkota Inn, Pierre, South Dakota. The committee met jointly with the Board of Trustees of the South Dakota Retirement System (SDRS).

A quorum was present with the following members answering the roll call: Senators William Earley, Kenneth Albers and Clarence Kooistra; and Representatives Mel Olson, Tim Rounds and Lou Sebert. Excused were Senators Dan Sutton and Paul Symens; and Representatives Burt Elliott and Matthew Michels.

Annie Mehlhaff, Principal Fiscal Analyst, and Reta Rodman, Legislative Secretary, staffed the meeting.

(**NOTE:** For sake of continuity, the following minutes are not necessarily in chronological order. Also, all referenced documents are on file with the Master Minutes.)

Welcome and Introductions

Mr. Elmer Brinkman, Chair of the South Dakota Retirement System Board of Trustees asked all members of the Retirement Laws Committee and the Board of Trustees of the South Dakota Retirement System (SDRS) to introduce themselves. **Mr. Rob Wylie**, Administrator, **Mr. Steve Myers**, State Investment Officer, and **Mr. Paul Schrader**, Consulting Actuary, Mellon Associates, each introduced their individual staff members.

Update of SDRS FY 2004 Investment Performance

Mr. Steve Myers, State Investment Officer, stated that the out performance of the fund will never be repeated in the next thirty years and that by SDRS keeping their costs low, there was a cushion of \$98M in the fund. He stated that because the annualized rates of return had consistent performance over the past thirty years, the SDRS fund ranked in the top 1 percentile for the first two decades, with annualized rates of return of 10.2% and 13.4%, respectively, and in the 2 percentile for the third decade, with an annualized rate of return of 9.5%. At the present time, the assumed rate of return on the retirement system assets is 8% and he feels the assumption should be lowered to 7.5%.

Reserve and Cushion Preliminary Projection at June 30, 2004

Mr. Paul Schrader, Consulting Actuary, Mellon Associates, stated that the investment return to date is approximately 14.9% with April's return being 15.8%. He advised not to count on the 14.9%, as the market can change dramatically in the next two weeks. **Mr. Schrader** distributed copies of an overhead presentation entitled "Preliminary Projection of SDRS Funded Status, Reserve and Cushion as of June 30, 2004" (Document #1). He stated the following as of June 30, 2003:

- Actuarial Value Funded Ratio = 97%
- Market Value Funded Ratio = 99%
- Cushion = \$98M
- Cumulative Balance in Reserve = (\$57M)
- Net Gains in Pipeline to be Allocated to Reserve = \$70M

Mr. Schrader also indicated that if the investment return for the year ending June 30, 2004, is 14%, the Actuarial Value Funded Ratio would be 97% and the Market Value Funded Ratio for the same date would be 105%. At the end of June 30, 2003, the actuarial value funded ratio was 97% with 99% being the market value funded ratio. He also indicated that if the investment return for year ending June 30, 2004, is 14% the cushion would be \$391M; cumulative balance in reserve to be \$50M and there would be \$256M in the pipeline. The last 3 years has been a very tough period. The challenge is to decide how big the cushion needs to be. Some members felt the cushion should be 120% before any benefit increases are considered.

Mr. Schrader indicated that the Wilshire Associates Study of Funded Status of State Retirement Systems (Document # 2) ranked SDRS second nationally on market value funded ratio basis at 99%; 126% in 2000; 114% in 2001; 101% in 2002 and 99% in 2003. The Wilshire Study found seven systems changed their investment return assumption effective June 30, 2003:

- One System reduced the assumption from 8.5% to 8.0%;
- One System reduced the assumption from 8.25% to 8.0%;
- Three Systems reduced the assumption from 8.0% to 7.75%;
- One System reduced the assumption from 7.7% to 7.5%;
- One System increased the assumption from 7.75% to 8.0%;

Ms. Koren Holden, Associate Principal Retirement Actuary, Mellon Associates, stated that the SDRS fund is actuarially sound. She distributed an exhibit entitled "South Dakota Retirement System, Analysis of Actuarial Experience July 1, 1998 through June 30, 2003 and Recommendations for Assumption Changes" (Document #3).

Background: Mellon was asked to conduct an assumption review (or experience analysis). The review looked at all of the assumptions used in the annual actuarial valuation, independent of all other assumptions.

Objectives of Review & Analysis: A prudent and methodical review will result in the selection of actuarial assumptions that are realistic and explicit and are appropriately conservative given the public trust and fiduciary responsibility of SDRS.

Methodology: The methodology used 5-10 year cycles. Mellon reviewed a 5-year cycle for SDRS looking at fiscal years 1999 through 2003. They looked at each individual assumption – economic and demographic. The consulting firm used professional judgment to estimate possible future outcomes based on past experience and trends.

Discussion & Analysis: Economic Assumptions & Outlook: The economic assumptions reviewed and analyzed were: inflation & investment return, salary scale, investment return credited on employer/member contributions, expenses. For the period 1991 to 2003 the annual inflation was 4.5%--annual real return of 3.5% with the total annual return of 8.0%. If SDRS earns less than 8% due to lower inflation, funded status would not decline if all SDRS benefits also decline by the same amount.

Economic Assumptions: Recommendations are based on long-term experience; legislation last year that removed \$300M of future liabilities which will be recognized over time of 10/20 years; and conservatism of other assumptions and consistency with average practices. The Board of Trustees approved the recommended demographic assumption changes proposed by Mellon. Additional discussions will be held at the September 2004 meeting regarding other changes proposed to the current assumptions.

SDRS Membership and Experience Report

Rob Wylie, Administrator, reported that his office has seen a frenzy of activity since the legislation passed in the 2004 session. There are 65,469 members in the retirement system with 90% still living in South Dakota. \$200M was paid out this year with the assets fully funded. A handout was distributed entitled “South Dakota Retirement System Membership and Experience Report for Fiscal Years 2003 and 2004” (Document #4). On an 11 month to 11 month comparison the increase was only 2% in benefits though he felt it would be more. The number of retirees did not materialize as they thought it would. \$157M was created in the 11 month period with the increase being from contributions.

Concerns regarding the retire/rehire shows 500 in the group which is up from 400 last year. The numbers have increased by only 10% after the 2004 legislation change. **Mr. Wylie** advised that the retire/rehire is primarily from Class A and will go down over the next number of years. Of that total, Class B has just over 50.

FY 2006 Budget Request

Mr. Wylie, advised that there would only be a 1% increase in the budget. The total SDRS FY 2005 approved budget is \$2,941,342 with the FY 2006 proposed budget being \$2,972,560. The FY 2005 approved budget has 31.0 FTEs and the FY 2006 proposed budget requests 31.0; therefore, there is no increase in FTEs.

Potential Legislation

Mr. Wade Hubbard, SDRS staff attorney, advised that the Board had asked him to draft a bill to extend the time for veterans to purchase service at reduced rates. The time frame is yet to be decided. Another issue to be addressed by the legislature is the issue of handling the vacancies on the SDRS Board of Trustees. At the present time there is only an informal policy to handle such vacancies.

Discussion

A discussion was held between **Representative Mel Olson** and **Mr. Myers** regarding the lowering of the 8% assumed earnings to 7.5%. **Representative Olson** felt that the Board of Trustees of the South Dakota Retirement System (SDRS) might consider placing a benchmark on the amount held in reserve. Mr. Brinkman indicated the board would take it under advisement when discussing the issue at the September meeting.

Senators Earley and **Albers** indicated to the board that the Retirement Laws Committee would be willing to meet with the Board of Trustees if they felt it would be beneficial to both groups. It was decided that **Senator Albers** and **Mr. Brinkman** will be in contact and a decision will be made if a joint meeting should be scheduled.

The following motion was presented to the Retirement Laws Committee members for review and approval.

ADMINISTRATOR'S COMPENSATION – It was moved by Ms. Dahl-Webb, seconded by Mr. Berglin, to approve a 10 percent raise for the administrator effective on his six-month anniversary based on the exemplary job performance during the past six months and to further increase the administrator's compensation by 3 percent – the same across-the-board percentage increase for fiscal year 2005 as the legislature approved for state employees. The motion passed unanimously on a voice vote by the Board of Trustees of the South Dakota Retirement System (SDRS).

SENATOR ALBERS MOVED, SECONDED BY REPRESENTATIVE ROUNDS THAT THE RETIREMENT LAWS COMMITTEE APPROVE THE INCREASE IN THE ADMINISTRATOR'S COMPENSATION. MOTION PREVAILED ON A ROLL CALL VOTE WITH 6 VOTING AYE, 0 VOTING NAY, AND 4 EXCUSED. Those voting **AYE**: Albers, Earley, Kooistra, (Mel) Olson, Rounds and Sebert. Those **EXCUSED**: Elliott, Michels, (Dan) Sutton and Symens.

Adjournment

REPRESENTATIVE SEBERT MOVED, SECONDED BY REPRESENTATIVE ROUNDS, THAT THE COMMITTEE BE ADJOURNED. THE MOTION PREVAILED ON A VOICE VOTE.

THE COMMITTEE ADJOURNED AT 12:30 P.M.



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